



The Evolving Role of the Head of Risk

The changing risk management
environment

ADVISORY

Introduction



In the current economic climate, the role of the risk management function has never been so prominent to the success of an organisation. Enterprise Risk Management (ERM) processes are often at the centre of change in many leading organisations.

ERM techniques are now found in regulatory tenets and codes of practice, with the principles present in boardrooms around the world and are even being incorporated as a factor in credit ratings.

Yet, the field of ERM continues to evolve and risk management functions need to ensure that they keep pace with these changes.

Emerging risk practices at leading organisations

- Provides credible risk governance
- Inputs to strategy formulation
- Integrates risk management and strategy execution
- Aggregates information to identify operational control weaknesses
- Addresses operational risks early
- Incorporates risk in programme management
- Focuses on risks to reputation
- Builds a risk management dashboard
- Uses behavioural change management techniques to maintain risk awareness capabilities
- Coordinates with assurance providers to provide an opinion on the control environment

Market drivers for change

The new world economy is fraught with change, risk and uncertainty. The idea that businesses fail and become extinct through natural economic forces is becoming more widely accepted. However, it is an outcome that all executives, directors and Heads of Risk want to prevent.

There are new ways of using human resources in the organisation, such as new employment models, technological connectivity and disaggregating job functions.

These changes offer many opportunities, but they come with certain inherent risks. Employees are spending more time in an informal training environment, through online courses or e-learning and education forums, as opposed to classroom training.

We live in a world of global mobility and employees have the ability to work anywhere at any time.

Changes in society, such as cyber crime, media power and shadow economies pose many threats, uncertainties and opportunities. The needs of customers are changing they expect innovation, purchase on the basis of ethics and use technology for greater convenience.

Markets are increasingly volatile and unpredictable with single events often defining the future for many organisations. Market change, including

open standards, global supply chains and alternative manufacturing centres are opportunities for some, but risks for others.

Changes such as product proliferation, cost of capital and pricing pressures are under the microscope of most executive teams and their Heads of Risk.

New forms of competition are often faster to market than traditional businesses and with lower costs. Some sectors face shorter product life cycles, shifting industry sectors and new ways of trading with the market.

Emerging issues such as climate change are on the agenda of many company boards, which have to face risk-related choices regarding alternative energy, pandemics and carbon trading. New and unanticipated technology, including biotechnology services, robotics and continual defect monitoring create risks, both upside and downside, for many.

The impact on management teams

This spectrum of change can be bewildering to management teams who have to make sense of all the change and respond with rational business plans.

Stakeholders of the modern organisation have an expectation that management understands change and is safeguarding their interests with prudent decision making and robust internal processes.



Regulators are encouraging management to focus on risk through legislation, self-regulation and industry codes of practice.

The modern organisation is expected to manage risk in a prudent and structured way. This has manifested through certain developments, such as, rating agencies including ERM criteria in the credit rating assessments, international frameworks for ERM, increased focus on compliance risks and the rise of the role of the Head of Risk.

The gradual pace of change in previous times enabled management to confront risk through adaptation. Even today there are many management teams who believe that individual management competency is sufficient to address uncertainty. However, studies show that people do not always make rational decisions in the face of uncertainty or those consistent with the board's risk appetite.

The volatility of change in today's global economy requires structured interventions to process the data and information related to change. Intrusive ERM processes are required to break through management's familiar conditions.

It is not enough for risk processes to focus solely on short to medium term risks to strategy execution – risk input to strategy formulation is essential for longer term business resilience.

Head of Risk

– skillsets and remit required

The work of the Head of Risk focuses increasingly on risk information management, the implementation and maintenance of risk processes and behaviour modification.

The Head of Risk must be equipped with a remarkable set of skills. The person fulfilling the role should have project management skills, an ability to network with employees across the entire spectrum of the organisation and the capacity to challenge the status quo.

The Head of Risk must have a thorough grasp of all ERM principles and techniques and be familiar with strategy, governance, compliance and performance dynamics. The specific risks of the organisation need to be ingrained in business discussions.

Heads of Risk are unique as they have the ability to engage with other risk related functions such as internal audit, treasury, strategy, insurance and other corporate oversight functions. The Head of Risk must be competent in communicating with directors, management and employees of all levels.

The organisation-wide perspective of Heads of Risk, requires them to introduce and maintain risk management processes and interventions in every corner of the business.

Risk governance

Today, much of what is recognised as ERM is borne out of the corporate governance requirements of various economies.

A key principle behind risk governance is that stakeholders want transparency around an organisation's risk management arrangements. This includes a view of internal controls and processes for responding to risk. Shareowners expect the board of directors to provide them with credible assurance that their interests are protected.

The Head of Risk's role is to ensure that risk governance is applied. This will include activities such as helping the board to formulate a risk philosophy, to define the organisation's risk appetite and to build risk-based improvement and assurance processes.

Underpinning risk governance will be a series of ERM processes, including board reporting, board charters, board risk committees and risk assurance.

ERM implementation

The processes and techniques of ERM are diverse and include risk identification, assessment and quantification, aggregation reporting, monitoring, and control improvement.

There are various techniques unique to ERM, according to the demands of the organisation's risk profile. These could include risk analysis techniques, risk appetite, key risk indicators and risk-adjusted business planning.

One of the key benefits of ERM is that it should provide the board, executive and management with a single view of risk, control performance and assurance on the overall control environment.

Risk-based strategy

There is an increasing expectation from senior executives that the Head of Risk has an essential role to play in shaping corporate strategy.

Accepting that the risk-reward model is fundamental to business dynamics, it stands to reason that the risk information generated by ERM processes must be used as a compass for future investments and competitive strategies.

In a climate of corporate governance obligations, much of the focus of ERM is on downside risk. However, there are clear indications that the role of ERM has evolved and is also focusing on upside risk.

This means that ERM should include processes of opportunity management, apply interventions that will identify risk taking prospects and will use risk information to improve performance.

Leading companies already incorporate these processes in a structured way into their annual strategy setting and business planning discussions.

Key considerations in developing ERM processes

- Focus on the future and take a proactive approach to identify risk
- Place the greatest investment into change management and empowering people
- Don't depend entirely on subjective risk perspectives – collect real data
- Work with management to solve risk-related challenges
- Make sure that assurance processes permeate through the organisation





Risks to reputation

Although much of the work of ERM prevents harm, it has become clear that the value of reputation is far too high to leave unrecognised.

Many good organisations have fallen on the basis of tarnished reputation and a confidence crisis. Sources of reputation risk can arise from governance scandals, strategy mistakes, brand sabotage, performance failures, and service break-down and product faults. The fact is that it takes just one adverse incident to affect an organisation's reputation and cause its downfall.

Reputation risk management must feature prominently on the Head of Risk's agenda and responsibilities.

Experience suggests that organisations manage reputation from within, but that the reputation risk exposures from external sources, for example, changing stakeholder expectations and action, are not commonly understood. The Head of Risk is expected to include processes, techniques and behaviours that deal with the full spectrum of reputation risk.

Risk identification, measurement and response processes are applied to stakeholders, for example shareowners, customers, opinion formers, communities, regulators, business partners, suppliers and the media. Crisis management competencies are normally considered essential for the modern organisation.

Change management

Many organisations around the world have learnt that the introduction of risk related processes is insufficient to fundamentally change behaviours.

Management sometimes see ERM as unimportant bureaucracy and do not understand all its advantages.

There is sometimes a resistance to adopting new risk-related processes, especially if accountability for risk and internal control is not clearly communicated.

The evolving role of the Head of Risk includes being a catalyst for change in risk-related behaviours.

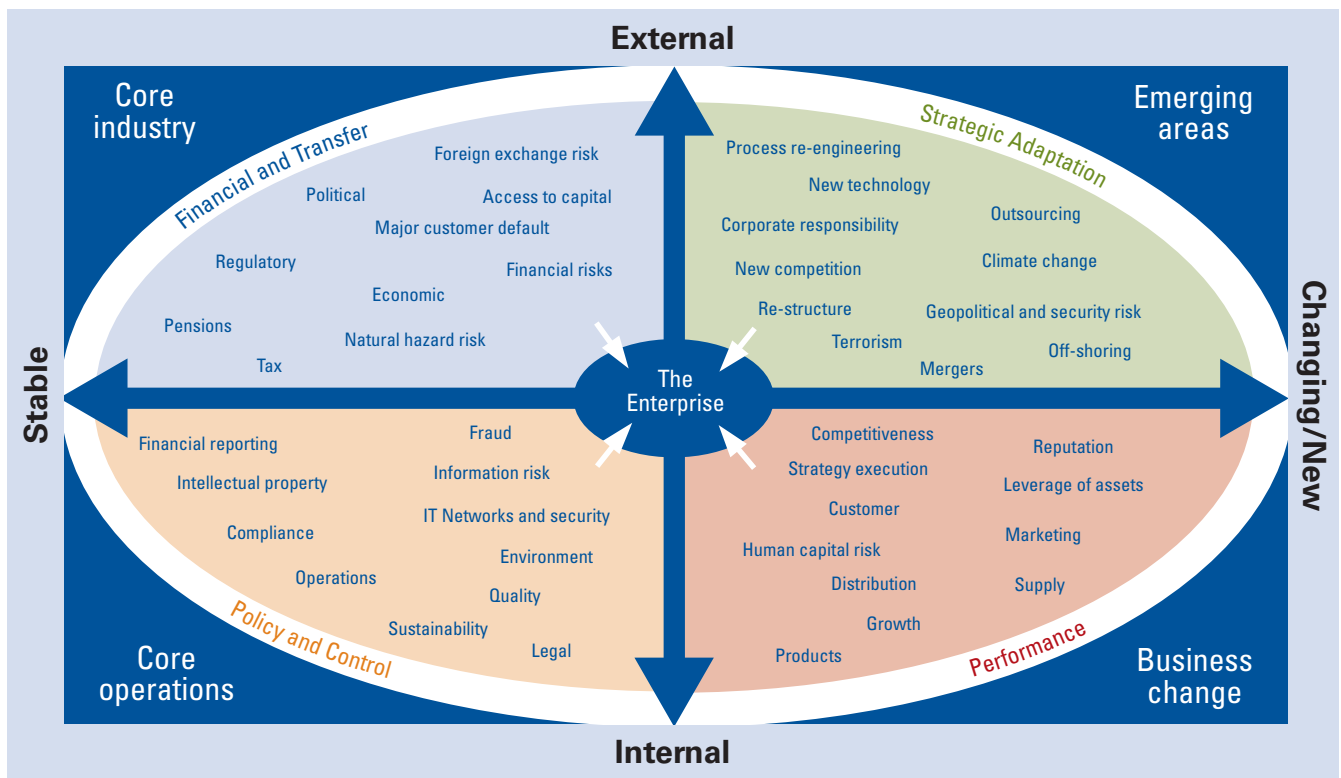
The objective of most ERM strategies is to make management and employees more alert to emerging risks, more proficient in risk identification and more proactive in responding to risks (upside and downside).

To encourage desired behaviours often requires a campaign of change management interventions. These may include awareness surveys, training, communication processes, designing a common language of risk and internal control, measurement of risk competency and performance incentives.

Many organisations have indicated that one of the most beneficial outcomes of ERM is risk awareness. Management becomes more proactive in dealing with risk management processes because of their greater understanding of its goals. Decision making is also more informed when it is based on reliable and meaningful risk information.

Enterprise Risk Management components, tools and techniques:

For a truly enterprise wide risk management approach, the Head of Risk should ensure there is consideration across the entire portfolio including all broad risk categories, be they, internal or external, operational, change related or emerging and strategic in nature.



There are many tools and techniques at the disposal of the Head of Risk and depending on the maturity of the risk management approach and the industry sector, some or all of the examples below may be applicable:

- Aggregation
- Risk optimisation
- Quality assurance of RM
- Key risk indicators
- Real options
- Volatility analysis
- Resilience analysis
- Combined assurance
- Correlation
- Controls transformation
- Integrated framework
- Trend analysis
- Opportunity management
- Strategy alignment
- Stakeholders
- Risk appetite
- Integration
- Upside risk
- Risk-based portfolio
- Investment budgeting
- Risk-based strategy
- Risk governance
- Single view of risk
- Tolerance limits
- Risk disclosure
- Scenario planning
- Programme/project RM



Risk information

Information is the lifeblood of an ERM system. It is vital that the Head of Risk is able to collect and interpret risk information that is accurate, credible and complete and encourage management to act on this information.

The Head of Risk will develop a strong set of data and information to support risk identification and decision-making. This will lead to the design of key risk indicators and tolerance thresholds.

Many leading organisations have structured their critical risk information into risk dashboards. This assists management to frequently view risk trends. Leading edge risk dashboards reflect risk indices that include information about the risks, control performance and loss data.

Measuring risk in an objective and finite way is usually favourably received by management as it should provide solid basics for investment decisions to improve risks.

Optimising Controls risks

Many of the emerging techniques of ERM are predominantly to benefit senior management and the board. There are various risk management activities at operational level that also need to be addressed by the Head of Risk.

Aligning the organisation's insurance portfolio with its risk need and tolerance limits is critical. In addition, ensuring that board assurance processes incorporate safety, health and environment activities is also important. There are many risks within operational business processes that should be identified, assessed and mitigated. Identifying emerging risk issues such as climate change, pandemics and terrorism are also the responsibility of the Head of Risk.

Invariably, there are new initiatives that must be addressed from a view point by the Head of Risk, such as mergers and acquisitions, projects, new product development and events.

Problem areas, including customer service, employee turnover and safety incidents should not wait for ERM processes to be introduced, but should be dealt with immediately.

The risk processes should review loss prevention within the organisation and correct any operational shortcomings.

Conclusion



The role of the Head of Risk is no longer confined to the implementation of corporate functions such as insurance, treasury and compliance. The role has become of strategic importance.

The Head of Risk must support strategy formulation and business planning with valuable risk information. The Head of Risk should be a facilitator with an ability to change risk-related behaviours and should work with the assurance provider of the business to champion the introduction of intrusive processes that challenge, test and validate the internal control environment.

Ultimately, the Head of Risk needs to build the organisation's competency to withstand the assault of change in the marketplace and to seize the opportunities presented by its uncertainties.

It is becoming more common to see risk owned by the executive committee of an organisation. This is because risk management performance is often on the board agenda and is becoming routinely incorporated into key initiatives such as stock exchange listings, mergers and acquisitions as well as major capital projects.

Risk management is no longer seen as a collection of unrelated functions but as an integrated organisational competency. This shows that risk management is accepted as a valuable function in modern business to support performance as well as achieve compliance.

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